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Economic Times

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Editor's Note

We open the new year with an unusually interesting assortment of stories, starting with opinions from our Colloquium about the dominant economic policy issue of the day—whether or not fiscal stimulus is appropriate at this juncture. Marvin Zonis then talks about the risks inherent in the disintegration of the U.S.S.R. Next we get an insightful quote about the environment by Alcoa's Paul O'Neill, followed by William Schneider's views about how the suburbs have come to dominate presidential voting in this country. Then from Earl Butz a typical, no-punches-pulled analysis of U.S. farm policy.

In addition, this being the first month of the quarter, we provide (in the shaded center section) our quarterly special feature, the "Industry Outlook Report," a roundup of the prospects for seven important industries.

Best wishes to all for 1992!

Ed Fiedler

Maxim of the Month:

Take the humbug out of this world, and you haven't much left to do business with.

Josh Billings
(pseudonym of Henry Wheeler Shaw, American humorist, 1818-1885)

Confidence Index? Or Confusion Index?

The dramatic plunge in consumer confidence this fall has raised some interesting questions. One is the oft-heard idea that our economic problems are all the media's fault: We're being "talked into" a recession by the press and TV. Except for their unrelenting negativism and unwarranted pessimistic interpretations, this argument goes, consumers would pursue their customary free-spending ways, businesses would be hiring and investing, and the economy would be strong, not weak.

This idea is implausible on two grounds. First, although we observe a general correlation between the confidence index and the business cycle, this does not mean that swings in sentiment are a major cause of recessions. A drop in consumer confidence is a consequence of recession, but not an important initiating factor, at least not by itself.

Second, consumer attitudes are probably shaped very little by the media, but primarily by personal experience, that is, by seeing the monthly electric bill suddenly go from $100 to $125, or by hearing that your brother-in-law was laid off. That's what worries Joe Sixpack enough to alter his normal spending patterns. On the other hand, what Peter Jennings says is mostly entertainment, without much more economic impact than a movie or a play. One exception that comes to mind was Reagan's firing the air controllers; that episode, promulgated mostly by the media, did get people's attention, even those not directly involved.

I am *not* saying the media have no impact on how our society behaves. I am *not* saying their messages are balanced. But neither do I want to ascribe to them enough power to manipulate the economy. Even with their howls of despair at full decibel, they are not capable of talking us into recession.

The second and more difficult issue is how to explain the recent drop in sentiment. Usually a sharp decline in attitudes can be traced to something fairly specific, like Iraq's invasion of Kuwait, or gasoline prices skyrocketing. Not this time. Long ago, Al Sommers found a fairly close relationship between consumer sentiment and stock prices, the rate of inflation, the factory workweek, and more recently help-wanted advertising. But none of these indicators, individually or collectively, deteriorated sharply this fall when the confidence index collapsed. So the historical pattern seems to have broken down.

One possible explanation is that sentiment improved last spring because of the Gulf War victory, but then collapsed again this fall when we found the recession still with us. This seems plausible at first pass, but it crumbles when you look at the full range of cyclical indicators. The only other series that's turned somewhat sour lately is initial unemployment claims. But if the recession were "double-dipping" now, we ought to have seen meaningful deterioration in many of the following: the stock market (normally the most sensitive cyclical indicator of all), housing starts, new orders for durables, the factory workweek, and vendor performance. These series aren't so favorable that we can ignore the plunge in sentiment, but neither do they point toward recession. It's difficult to know, therefore, how much analytical weight to assign to this serious drop in consumer confidence. Alas, our index of confidence is also a source of confusion.

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Colloquium: How to Energize the Economy

Background:

The sound and fury in the media focus on the underperformance of the economy. The politicians and pundits are nearly unanimous in calling for something—in addition to Federal Reserve action—that would provide geritol for an anemic recovery. The policy advice encompasses everything from middle class tax relief to reinstatement of an investment tax credit to a cut in capital gains tax rates to new IRAs to more federal spending on infrastructure and education.

Question:

What's your prescription? What, if anything, should the President and Congress do at this stage to energize the economy?

Note: These answers were written just before the Federal Reserve reduced the discount rate to 3 ½ percent on Friday, December 20, 1991.

John T. Dunlop
Harvard University

Diagnosis: The normal recovery and growth genes of the economy have been structurally damaged by a profligate past—household, corporate and government debt, an impaired financial sector, and belated difficulties of adapting organizations to new markets and technologies. The political tone is destructive with social conflict.

Prescription: Two placebos, a larger shot of monetary juice, and a lot of quiet remedial work on the structural ills. The patient will not be well for some time.

Robert G. Dederick
The Northern Trust Company

What this country needs is a 3 ½ percent Fed funds rate—*now*. And, if that doesn't do the trick, something lower. What it does *not* need (but, of course, almost certainly will get) is a bidding war over budgetary ease. Monetary policy has three great virtues: (1) It can be moved toward stimulus *today*. (2) It can be reversed *tomorrow* if conditions change. (3) Its use now would help ward off at least the *worst* fiscal excesses. So, the President and Congress should leave the recovery baby where it belongs—on the Fed's doorstep.

Charles L. Schultze
The Brookings Institution

For the Fed, "Don't just stand there, do something." For the Administration and the Congress, "Don't just do something, stand there." The last thing the American economy of the 1990s needs is an election year bidding war over tax cuts. If by spring the economy remains stalled, then a temporary investment tax credit should be considered.

Albert M. Wojnilower
First Boston Asset Management

Nothing will help much until the official capital requirements strangling bank credit are overridden. The Fed must give absolute priority to credit growth. Only in new ventures can joblosers in large corporations and the defense industry salvage their futures. They must be able to borrow despite limited capital. Bolstering lower-income workers, preferably by reducing social security taxes, is the sole potent fiscal medicine. An investment tax credit or small-business capital-gains relief will mean little unless credit eases.

Members:

Members of The Conference Board Economics Colloquium are: Stephen H. Axilrod, Vice Chairman, Nikko Securities International; Andrew F. Brimmer, President, Brimmer & Company; Don R. Conlan, President, Capital Strategy Research; Robert G. Dederick, Executive Vice President and Chief Economist, Northern Trust Company; John T. Dunlop, Lamont University Professor Emeritus, Harvard University; Lyle E. Gramley, Senior Staff Vice President & Chief Economist, Mortgage Bankers Association; Isabel V. Sawhill, Senior Fellow, The Urban Institute; Charles L. Schultze, Senior Fellow, The Brookings Institution; James Tobin, Sterling Professor Emeritus, Yale University; Laura D'Andrea Tyson, Professor of Economics, University of California, Berkeley; Charls E. Walker, Chairman, Charls E. Walker Associates; Murray Weidenbaum, Director, Center for the Study of American Business; Albert M. Wojnilower, Senior Advisor, First Boston Corporation.

The Danger of Civil War in the Former Soviet Union

by Marvin Zonis

The agreement between the presidents of Russia, Byelorussia, and Ukraine to establish the Confederation of Independent States (CIS) marks the final disintegration of the U.S.S.R. The formation of the Confederation promises greater instability within the rapidly collapsing superpower.

Minsk has been designated the capital of the new Confederation, a city notable primarily for having the best hotel between Warsaw and Moscow. Minsk as the capital insures that the institutions of the Confederation will be trivial. There are few communications links between Minsk and the rest of the Confederation and certainly not enough to exercise extensive power. The center will be weak and control over the nuclear weapons of the U.S.S.R. will remain uncertain.

The new political arrangements do not in the least portend any arrest of the economic collapse now seizing the country. The central government has been covering its budget deficit by printing rubles. In the former U.S.S.R., control of the money supply was determined solely by the speed of the printing press. As a result, the country stands on the brink of hyperinflation. The black market rate for dollars was 40 rubles to the dollar only a few months ago. By mid-November, the rate had hit 100 rubles to the dollar. (The average monthly Moscow factory wage is 300 rubles.)

As the value of the currency collapses, the people flee from the ruble, spending their days trading goods for other goods, anything to avoid taking rubles. (In the land of inflated currency, the dollar and the D-Mark are king, but a pack of Marlboros is a close second.) The new barter economy is just another inefficiency added to an already archaic economy.

The economy remains a command economy. But the collapse of political authority at all levels means that there is insufficient power in the institutions of the state to issue and enforce commands. Even Boris Yeltsin learned that to his humiliation. He was the hero of the thwarted August coup. Yet he found his power limited even within Russia. A retired Soviet Air Force general, Dhohkar Dudayev, called for elections in the Chechen-Ingushtia autonomous region in the Caucasus as a protest of the government's support for the coup. Despite Yeltsin's declaration of the election as illegitimate, Dudayev went ahead and, not surprisingly, was elected president. He duly inaugurated himself and declared his district an independent country. Yeltsin sent Russian Interior Ministry troops to put down the insurrection. But the Russian Parliament denied his authority and called for negotiations. The troops were withdrawn.

The presence of more than 15,000 tactical nuclear weapons raises the staggering spectacle of a nuclear civil war.

The ruble: 40 to the dollar on the Moscow black market a few months ago, it now takes 100 of these to buy a dollar. Russia is on the brink of hyperinflation.

The state, even the Russian state, does not have the power to command. Neither does it have the power to institute the mechanisms that would allow for the functioning of a market economy. For above all, a market economy requires predictability through a legal system that governs economic transactions. But the institution of a legal basis of a market economy requires both orderly legislative procedures and mechanisms to enforce the newly adopted laws. Both are absent in the former Soviet Union.

In the absence of command and in the absence of the mechanisms for a market economy, the economies of the emerging republics that will replace the U.S.S.R. have fallen prey to corruption, banditry, and self-serving greed. As a result of these factors, the overall output

of the economy continues to fall at the rate of 1 1/2 percent per month.

As the political center and the economy collapse, it appears inevitable that the food distribution system will break down as well and food shortages will seize the country in the coming bitter winter. One result could certainly be mass migration westward into the former satellites but even more likely into the prosperous states of Europe, particularly Germany. The social disruption could be staggering.

Another possibility which must be taken ever more seriously is the possibility of civil war. There are many ways in which such a war might erupt. In Yugoslavia, the federal army, dominated by one republic, attacked the territory and people of another. That might happen in the U.S.S.R. Russia, for example, might use elements of the federal military to attack Kazakhstan to protect the Russian minority in that Muslim republic. There are large numbers of minorities in each of the republics and Russia itself is composed of scores of so-called "autonomous republics" peopled by ethnically and linguistically distinct peoples, such as the Chechen. They could seek their independence, as have the Chechen, or go to war to preserve the unity of their republic as the Georgians fought the Ossetians within Georgia. There is always the possibility that the agents of centralism, particularly within the military, will seek to use force to re-establish the power of the center. Other military units could side with their republics and fighting could break out between units of the armed forces.

Most fearsome, whatever the cause of the fighting, the presence of more than 15,000 tactical nuclear weapons raises the staggering specter of a nuclear civil war.

Despite the fact that the former U.S.S.R. has not played a major role in the international political economy, then, its fate is of foremost importance. The Group of Seven nations can ill afford to wait for the peoples of the former Soviet Union to settle their own troubled affairs.

Marvin Zonis teaches international political economy at the Graduate School of Business of the University of Chicago, and is the author of the recently published *Majestic Failure: The Fall of the Shah.*

Quotable Quote

Paul O'Neill on Industrial Development and the Environment

The experience of the past three hundred years demonstrates clearly that we can simultaneously achieve a significantly higher world living standard *and* a sustainable environmental relationship. Those with a more gloomy view make the mistake of believing that economic growth of the undeveloped and underdeveloped world must go through the same stages as have the developed countries, creating in their wake the same environmental trauma but on a wider scale. Recent economic developments provide strong evidence to the contrary. For example, the new entrants into the world automotive market did not succeed by creating products that were produced in the U.S. or Western Europe in the 1920s. They succeeded by going beyond the established standards of value at the time they entered the market. In a negative way the East German Trabant [automobile] makes the point that outdated and environmentally offensive products can persist in closed economies when they could not in open economies.

As the world has become more open to trade, *world* standards of value to the customer have replaced national standards. And world standards are being set by those with leading-edge technologies and organizational practices, not by those who are exploiting the environment and the people. In this there is a key message for structural change: The world and its people can benefit greatly, both economically and environmentally, by free and open trade.

In this same vein of thought, it seems to me there is a potential change in practice that could be taken almost immediately and on a voluntary basis that would be quite helpful to insure, in fact, that the undeveloped and underdeveloped economies do not follow the same track of environmental experience as the developed world. Namely, a voluntary agreement on the part of companies in the developed world to scrap rather than sell equipment and systems that are shut down in the developed world because of their unacceptable environmental performance. The lost secondary market value could be appreciable but I believe, with the heightened awareness of the worldwideness of our environmental predicament, many companies would subscribe to such an idea.

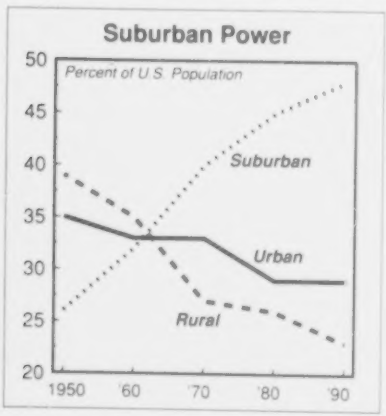
Paul O'Neill is Chairman and Chief Executive Officer of Aluminum Corporation of America. This statement is adapted from his speech to the World Industrial Conference on Environmental Management, April 10, 1991.

Presidential Voting: The Suburbs Rule

by William Schneider

The suburbs are the new power base in American politics. That's the message of the 1990 census. With 48 percent of the population now living in suburbs, it is almost certain that 1992 will be the first presidential election in which suburban voters will cast a majority of the votes. That's good news for Republicans. The suburbs are the key to that party's lock on the presidency.

In 1960, the nation was roughly a third urban, a third suburban, and a third rural. By 1990 (see chart) the suburban third had grown to almost half. The urban population slipped to under 30 percent. And the rural areas dropped to less than fourth. America is now a suburban nation, with urban and rural fringes.



The suburbs rule. But how do they rule? Presidential politics these days is a race between Democratic cities and Republican suburbs to see who can produce bigger margins. The suburbs are winning.

Since 1960, the urban vote has become smaller but more one-sidedly Democratic. So the Democrats' lead coming out of the cities was about the same in 1988 as it had been in 1960. The rural vote became smaller and more Republican. So the Republican lead coming out of the countryside also stayed about the same.

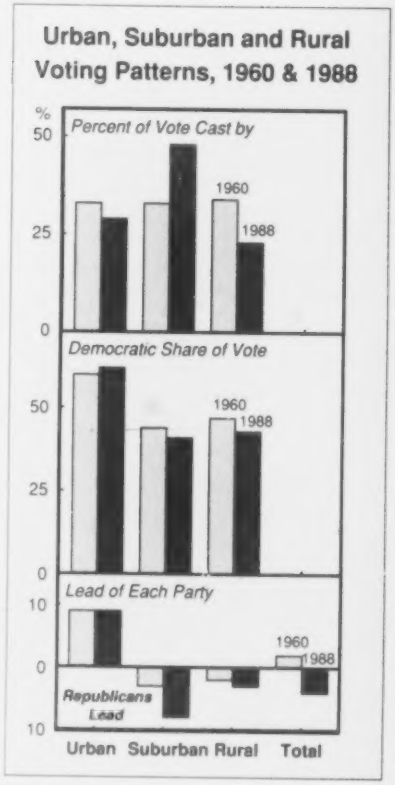
But the suburban vote grew larger and more Republican. In 1960, when the suburbs cast a third of the national vote, they generated a 3-percentage-point lead for the GOP. In 1988, the suburbs were almost half the vote, and they gave Republicans an 8-point lead, enough to overcome the Democrats' 7-point lead in the cities (see second chart).

What is happening is that the suburbs are growing larger faster than the cities are becoming more Democratic. That's tipping the balance to the GOP, not just nationally, but in a number of key states.

Take Illinois. In 1960, Chicago cast 35 percent of the Illinois presidential vote. With a little help from the Daley machine, the city voted 63 percent Democratic. In 1988, Chicago's vote was down to 23 percent of the state total. But with no apparent help from the Daley machine, the city voted 69 percent Democratic.

At the same time, the "collar county" suburbs around Chicago became slightly more Republican from 60 percent in 1960 to 62 percent in 1988. The number of people voting in those suburbs grew enormously, however, from 26 percent of the Illinois vote in 1960 (much smaller than Chicago's) to 38 percent in 1988 (much larger than Chicago's).

In 1960, the Democrats came out of Chicago with a 456,000 vote lead. The Republicans came out of the suburbs with a 254,000-vote lead. Illinois went Democratic.



In 1988, the Democrats came out of a smaller but more Democratic Chicago with a 420,000-vote lead. The Chicago vote was canceled out by a Republican lead of 423,000 votes in the burgeoning suburbs. Illinois went Republican.

A similar story can be told for Michigan-Detroit, Ohio-Cleveland, Georgia-Atlanta, Louisiana-New Orleans, and other areas. In other words, Republicans can afford to ignore the cities. But the Democrats, like many urban residents, have to worry about becoming trapped in them.

Excerpted with permission from *National Journal*, September 28, 1991. William Schneider is resident fellow at the American Enterprise Institute.

Industry Outlook Report

Overview: An O.K. Outlook

Edgar R. Fiedler
The Conference Board

Moderate optimism for 1992 is the dominant theme of the industry specialists gathered for this Report. The single notable exception is the small-business sector, where executives report that the economy is in the doldrums nationwide, and their optimism is waning.

In the other six industries, the mood is at least cautiously upbeat. Thanks to lower mortgage rates and the accumulation of some pent-up demand, housing starts are seen as climbing nearly 20 percent. In the metals and minerals sector, although prices are likely to drift near present levels, global demand is expected to grow modestly.

Marginal retailers and distributors will continue under pressure, but for the apparel industry as a whole 1992 sales growth should outpace inflation slightly and profits should rise more than the 10-15 percent anticipated for the entire economy. Although competition is intense in packaged foods, profits are expected to continue to grow in the 11-12 percent range. Some heavily indebted companies will take advantage of present lower interest rates by restructuring their balance sheets, thereby reducing interest expense.

In health care, the major policy issues of rising costs and limited access remain far from resolution, and the industry continues to grow at a much faster pace than the economy. Finally, the most optimistic report is for freight transportation, where revenues are expected to increase by a multiple of general economic growth. Productivity advances are being made through improved equipment utilization, advanced technology, reduced train crews, and strategic alliances among the different modes of transportation. Here, too, competition is severe and price increases will remain modest.

The moderately optimistic character of these industry projections stands in sharp contrast to the undiluted melancholy about the economy seen daily in the newspapers and on television, where the implicit expectation is renewed recession. In this respect, our specialists view their industries in much the same way that most forecasters are looking at the economy. Prospects are neither very good nor very bad, but the outlook is OK in that it's reasonable to expect a little expansion in activity in 1992.

Housing: Poised For Expansion, If

David E. Seiders
National Association of Home Builders

Housing starts fell to about 1 million units in 1991, the lowest level since World War II. The multifamily sector was depressed all year, and the single family market posted only a modest recovery from a cyclical trough hit in January when the Persian Gulf war erupted.

Foundations for a stronger single family housing recovery were built during 1991. A sizable amount of pent-up demand assembled in the wings following several years of below-trend home sales. Furthermore, housing affordability improved during the year as mortgage interest rates fell to their lowest level in 15 years and home prices receded in the weakest regions of the country. On the supply side of the single family market, unsold inventories of new homes dwindled to the lowest level since the 1982 recession, paving the way for an upswing in production.

Market fundamentals in the multifamily sector, on the other hand, were still quite weak as 1991 ended. Apartment vacancies remained high and provisions of the Tax Reform Act of 1986 continued to weigh heavily on investment incentives for rental housing. The condominium market also remained depressed, particularly in the Northeast region where heavy production of earlier years overhung the market.

Thus, 1992 begins with the single family housing market poised for expansion and the multifamily market facing a healing process that has not yet been completed. Further monetary easing by the Federal Reserve should help strengthen home sales and single family starts, despite very low levels of consumer sentiment at the start of the year. The multifamily market should stage a weak recovery by the second half as the overall economy improves and household formations pick up. Total housing starts should rise by nearly 20 percent in 1992, paced by an upswing in single family starts to about 1 million units. This outcome is contingent on relaxation of a "credit crunch" that severely constrained the flow of housing production credit during 1990 and 1991.

Apparel: Flexibility the Watchword

Jay J. Meltzer
Goldman Sachs

In the prosperous 1980s, so-called, the U.S. apparel industry was buffeted by mini-recessions in mid-1984-1985, late 1987-1988, and late 1989-1990. By early 1991, when many industries first acknowledged an economic downturn, excesses already had been wrung out of the fiber, fabric, and apparel system. Production was curtailed, prices stabilized, import growth flattened, and inventories reduced, often to unsustainably low levels. Part of the gradual improvement in apparel orders in 1991 to date reflected inventory replenishment, a partial return of private label importers to domestic sources (stimulated by state-of-the-art quick response programs), and higher exports. Encouragingly, consumer demand for moderately priced, basic goods also inched ahead in recent months. Thus, apparel seems to be in the forefront of economic recovery.

These trends should continue in 1992, but probably won't be enough to stimulate further significant growth for the industry. Rather, overcapacity and fierce competition should continue to bring pressure on marginal retailers and distributors. Outperformance should stem from creation and implementation of niche strategies, well-conceived programs, attractively valued products, increased productivity, and faster responses to consumer needs. National brands should accelerate their market penetration. Manufacturers' outlet stores should become an even more meaningful channel of distribution.

Flexibility will be the watchword of the 1990s, but size and ability to service dominant retailers also will be rewarded. Therefore, acquisitions, mergers, and consolidations, designed to enhance apparel companies' worldwide sourcing and marketing positions, should continue.

Overall, the apparel industry's sales growth in 1992 should outpace inflation slightly, while profit progress should exceed our expectation of a 10-15 percent rebound for the economy. We look for the large, well-run public apparel companies to do even better than the industry average.

Small Business: Stuck In The Mud

William C. Dunkelberg, National Federation of Independent Business

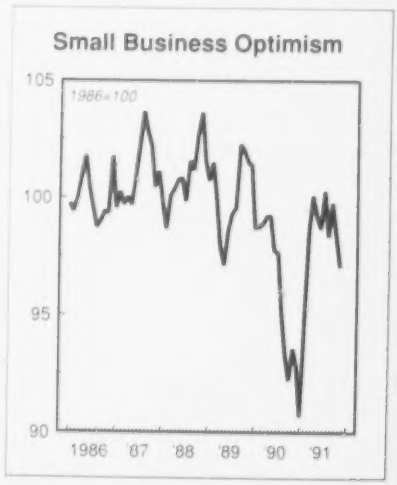
The economy is in the doldrums, the nation's smaller companies are telling us. The small business optimism index (chart) slipped again in November, with 9 of the 10 components losing ground. A 3-point gain in capital spending plans was the only exception, but too much unused capacity exists to justify broad gains in capital formation. Most of the other components look bleak, especially retail sales, employment, and earnings, where survey reports of improvement in mid-91 have subsequently been reversed.

Two sources of encouragement are inventories and inflation. Despite the sales declines reported in recent months, relative satisfaction with current inventories remains good. On the price front, the data are more dramatic: October was the first time in the history of the survey (initiated in 1973) that more firms cut selling prices than raised them. This is good news for inflation and ultimately for bond prices and interest rates.

October was the first time in the history of the survey that more firms cut selling prices than raised them.

Asked to identify their most important problem, these executives again put taxes (24 percent) at the top of the list, as they have for years. Weak demand was next (19 percent); a rising trend marks this as a growing problem. Then came regulation (16 percent). The "also rans" included labor costs (5), labor quality (5), credit crunch (5) and inflation (4). It's customers and profits that are in short supply, not (as Wall Street analysts so often contend) credit.

For the economy as a whole, although the odds of another recession seem relatively low, neither is there any substantial expansion in the offing. Everything is still better than last fall, but most indicators in the small business survey have recently reverted to a downward slope. In the year ahead, the economy may do well to maintain the 2-percent annual growth pace of the past half year, which is too slow to prevent unemployment and excess capacity from creeping higher.



Health Care: Status Quo Untenable

Samuel A. Mitchell
Federation of American Health Systems

The long heralded national debate on the nation's health care system may finally begin in 1992. There is universal consensus that the status quo is untenable; health costs (12.3 percent of GNP in 1990) are absorbing ever increasing shares of corporate, government, and consumer budgets. For a growing proportion of politically sophisticated middle class voters, health insurance is becoming unaffordable and even unavailable.

There is no consensus on what should be done. There are two basic alternatives: government expenditure controls and "managed competition." Government controls save money in the short run, but would subject 12 percent of GNP to political and bureaucratic control and would not save money long run because politicians are unable to say no to the American public whose thirst for top-of-the-line care on demand would not be abated by rate controls.

Managed competition involves increasing consumer cost consciousness by reducing the tax subsidy for employer-paid health insurance, and by insurance and health service market reforms to encourage price and quality competition, as well as by making insurance affordable for individuals and small groups. By restructuring incentives, managed competition promotes continuous improvement in patient outcomes and patient satisfaction per dollar spent and creates a consumer-driven health system, but it takes longer to work than expenditure controls.

The choice Americans make between these alternatives will greatly affect who pays how much for health costs, the short term rate of spending, and long term service and product improvements. Landmark legislation choosing one of these alternatives is unlikely in 1992, but there is some chance of enacting small employer insurance market reform. Major structural change is likely before the turn of the decade. Regardless, health expenditures will grow faster than GNP for the foreseeable future and, absent expenditure controls, doctors and hospitals will increasingly be subject to cost and quality competition.

Health Expenditures (Projected)

	1992 $ billion	average annual growth 1992-1995, %
Personal health care	717	10.1
Hospital care	314	10.7
Physician services	166	10.9
Dental	39	6.8
Drugs, medical non-durables	56	6.8
Vision, medical durables	16	7.5
Nursing home	65	9.7
Home health	9	12.5
Other	52	19.8

Metals And Minerals: Demand Rising, Prices Drifting

Phillip Crowson
The RTZ Corporation

Prices of most metals weakened considerably in 1990-1991. Overall demand, however, held up reasonably well with strong growth in Southeast Asia and parts of Europe offsetting weaknesses in North America and elsewhere. The outlook for 1992 is for demand to increase modestly over 1991's levels, gathering some momentum towards the end of the year. The main driving force will be the performance of industrial activity.

The fruits of investment in new mine capacity will come through more strongly in 1992-93. The impact on supply has so far been mitigated, in copper by inadequate smelting capacity, and more generally by a variety of disruptions ranging from Acts of God to civil war. Many of the disruptions directly result from the skimping of expenditure on repairs and maintenance, and the neglect of advance mine development during the 1980s recession. Where disruptions have been fewest, prices have fallen most.

The main complicating factor has been the collapse of Soviet and East European economic activity. This has greatly reduced internal demand, and diverted or increased exports of metals and minerals to the West in a frenzied scramble for hard currency earnings. The effects have been a rapid and unexpected build up in Western inventories and weakened prices for those metals where the Soviet Union's exportable surplus or existing stocks are greatest, such as aluminum, nickel and uranium. In other instances, such as molybdenum and tin, weakened Soviet imports have reduced the calls on Western exporters with similar effects. This Soviet imbalance will persist.

Western producers have generally adjusted their offerings too little and too late so that inventories have built up. The outlook consequently is for metal prices to drift for most of 1992 close to present levels, except where special factors operate.

Freight Transportation: Positive Prospects

Thomas J. O'Bryant
First National Bank of Chicago

Although real GNP growth for 1992 is expected to be sluggish (2 percent) but gradually improve throughout the year, the outlook for freight transportation is very positive, especially when three important trends are considered. Here's what to expect:

First, tonnage volume and revenues will increase by a multiple of GNP growth due to increased inventory investment moderated by today's just-in-time inventory management practices, and assuming reasonable price stability. Growth will be fueled by investment in capital equipment, not consumption spending. Freight hauled by private carriage will continue to shift towards common carriage due to cost and service efficiencies, thereby adding to the growth momentum for the freight transportation industry.

Second, significant productivity gains will materialize and costs will be reduced further through strategic alliances among truck, rail, air, and ocean shipping. By reducing transportation costs per mile and improving equipment utilization, the motor carrier industry is improving its productivity. Rail is putting into place new labor agreements that reduce train crews and modify work rules. Air cargo, now a global industry, is using advanced technology and route structure changes to increase worldwide system efficiency. Finally, by shifting the product mix to time-definite services, significant yield improvements will be achieved by all transportation modes even in a very soft market.

Finally, transportation companies are beginning to manage assets to maximize cash flow and attract needed capital. There is a recognition that transportation must generate a sufficient return on assets to attain capital or disappear, and this philosophy is taking precedent over the market share mentality of the late 1980s. This phenomenon is expected to spread because the shipping community is continuing to concentrate its high value freight among sophisticated providers with exacting quality standards and a commitment to improved overall service levels. As a result, we expect industry consolidation trends to accelerate and modest price increases to occur as discounting pressures moderate, even with continuing overcapacity.

Packaged Foods: Competition And Expansion

John M. McMillin III
Prudential Securities

Despite a more competitive domestic marketplace, packaged food company profits are expected to continue to grow in the 11 percent to 12 percent range in 1992, owing to expanding international markets and favorable ingredient costs. Lower interest rates should also let some companies reduce interest costs by restructuring debt absorbed in the 1980s.

The U.S. marketplace is more competitive as a result of several cyclical and secular factors. First, the recession is causing much more value shopping by consumers who formerly traded up. Private label products have staged a rebound in a number of categories, thereby forcing more couponing and other promotional efforts by packaged food manufacturers. Second, the growth of warehouse clubs and other discount retailers have forced traditional supermarkets to be more aggressive buyers, thereby making pricing flexibility more difficult for branded food manufacturers. Third, the severe industry consolidation in the 1980s has left a number of deep-pocketed competitors seeking a greater share of the consumer's stomach at seemingly any cost. Pet food, snack food and frozen food are just three major categories that have been gripped with more severe competition.

Packaged food companies are offsetting the more difficult domestic environment by expanding efforts internationally, including Mexico and Canada, both of which offer sizable opportunities as free trade accelerates. In Europe, major positions have been built up over the years by such companies as CPC, Heinz, Kellogg, Chiquita and Kraft. These positions are paying off in spades as European unity allows production and distribution efficiencies. In Asia, these companies plus Sara Lee and Borden are expanding product lines in hope of building a global brand comparable to Coca-Cola. Regional tastes make these global or even Pan-European strategies difficult challenges for food manufacturers.

Nutritional products, like cereal and pasta, seem to be best positioned in this increasingly health conscious environment. Taste and convenience still mean a lot, but consumers are demanding more low-fat alternatives and the new labeling regulation in 1993 should only accelerate this trend.

U.S. Farm Policy: Costly, Controversial, Counterproductive

By Earl L. Butz

Agricultural Policy in the United States is a mess. Despite near record levels of Federal payments to farmers, news stories persist of farm failures, and pressures on agribusiness firms. Commodity group is set against commodity group as, for example, grain producers seek higher prices and livestock producers grapple with artificially stimulated feed prices.

Our grain and cotton growers are geared to produce for the export market, but they are tied to governmental price and production programs designed primarily for the domestic market. Their first market, too often, is a government warehouse.

In several states in recent years, farmers got more than half of their net cash farm income in the form of a government check. University extension personnel and professional farm managers counsel farmers on how to maximize their government payments, rather than how to maximize yields or to minimize unit costs.

The political voice of American agriculture is in shambles. It arises as a babble from disparate commodity and special interest groups, seldom coordinated and often at each other's throat. We approach Washington as a bunch of predators, each bent on getting a larger slice of what ultimately will become a smaller pie.

It is instructive to note that only about 40 percent of U.S. farm commodities are under effective price support. Commodities without price supports include cattle, hogs, poultry, fruits and vegetables and, until recently, soybeans. These commodities, in the main, have been profitable. They don't cost the Treasury large sums of money. Producers are free to expand or contract as they choose. They need not seek "permission" from the county ASCS office to plan the scope of their operation. They have expanded their markets.

The troubled areas are precisely those commodities that have had the largest degree of governmental price intervention, including feed grains, food grains, cotton, peanuts, sugar, and tobacco. These are the commodities that have suffered market loss and have borne oppressive production and marketing controls. It is a basic observation that the more governmental involvement in pricing and marketing, the deeper the economic pit in which the commodity wallows.

What Should We Do? First, don't blandly ignore the agenda being put forward by the ecologists, the safe-food lobby, the organic farmers, the consumer activists and similar super zealots. They have strong public appeal. Some environmental actions, wisely guided, can protect agricultural resources and improve agriculture's eroding image with the nonfarm sector.

Second, get the government out of the commodity business. That path leads inevitably to expanded competition from abroad, to loss of foreign markets, to curtailed production at home, to the proliferation of government controls, and to reduced farm income.

We have in America a privately owned and operated food distribution system equaled nowhere else in the world. It has its imperfections, but it still turns in an amazing performance. As a matter of national policy, we should be committed to the preservation and strengthening of that system.

Basic observation: The more government involvement in pricing and marketing, the deeper the economic pit in which the commodity wallows.

What we have been doing obviously doesn't work. In the long run, farm income and rural welfare can never be enhanced by restricting production, increasing unit costs, withdrawing from markets, expanding governmental controls. The answer must be found in efficiency, lower unit costs, competitive pricing in export markets, favorable macro-policies in the nonagricultural sectors of government, loan rates at market clearing levels, a safety net under agriculture at a level that quits pretending that a government bin is a market, and a signal to our competition abroad that "the honeymoon is over."

Our farm policies are costly, controversial, and counterproductive. By contrast, although it's no nirvana, there is a discipline in the marketplace that works. Let's give it a try.

Earl L. Butz is Dean Emeritus of Agriculture at Purdue University. During 1971-76, he was U. S. Secretary of Agriculture.

Conference Board Stat File

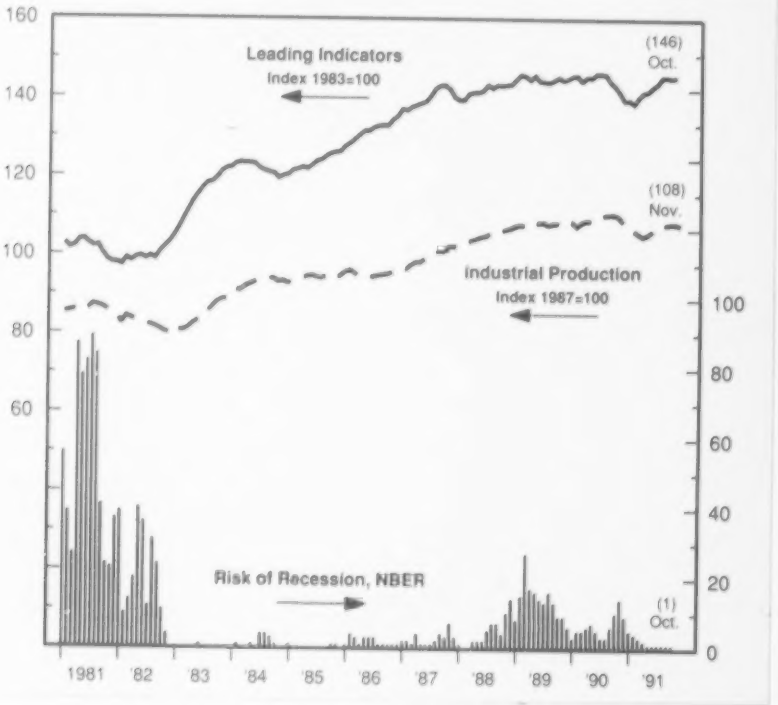
An Uncertain Trumpet

Economists have been talking recovery since spring, but the public disagrees. Mostly this is a difference in definition. To the public, a recession continues until jobs are widely available again. Forecasters, however, focus on direction: When output is falling, that's a recession. Once activity starts to rise again, as it did last May, the recession is over and recovery has begun. So both groups are correct.

Recently, however, the economists are having second thoughts. Since midsummer, what had looked like a brisk recovery has flattened out. In particular, consumer confidence and several labor indicators (pp.8 & 10) are quite negative. Some forecasters are looking for a "double-dip" recession (p.11). But the evidence is mixed, best summarized, perhaps, by the leading index (below), which points sideways, sounding an uncertain trumpet. It supports neither the bulls nor the bears. The guess here is very slow growth but no "double-dip."

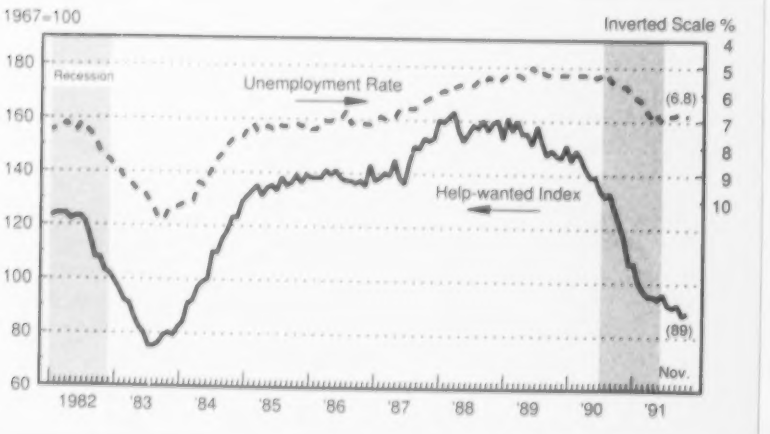
(Note: Data for Conference Board series in this section are available on request from Ken Goldstein at 212-339-0331.)

Early Warning Indicators



After brisk early recovery, leading index pointing nowhere.

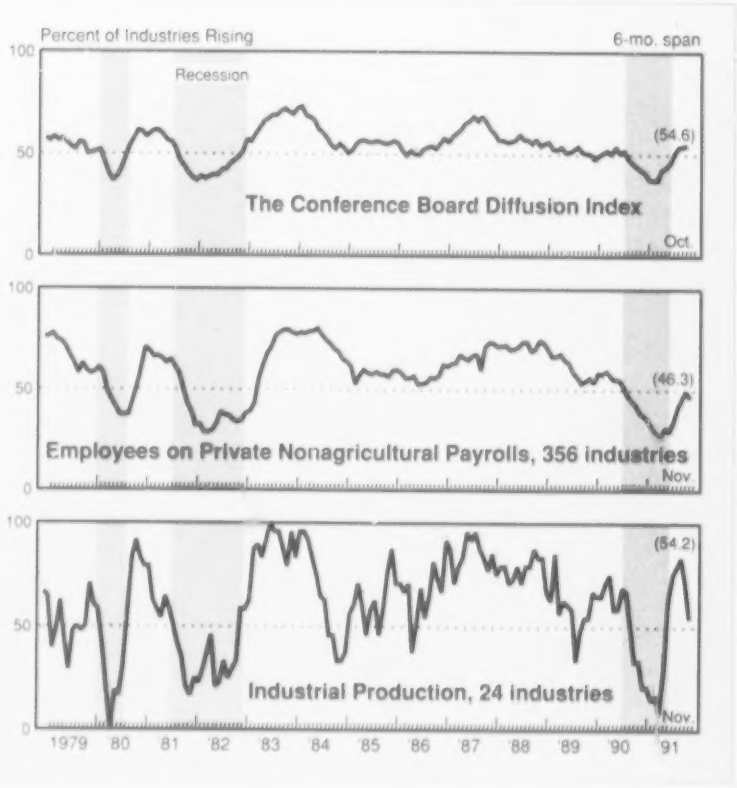
Help-Wanted Advertising and Unemployment



No sign of recovery in the labor market.

Conference Board Stat File

Indexes of Economic Momentum

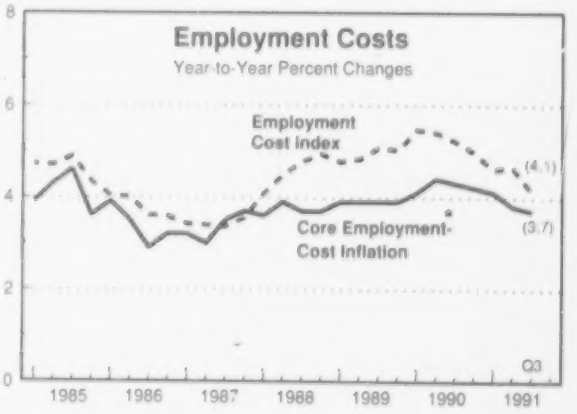


Momentum still favorable, but less so.

Encouraging slowdown of core inflation.

Inflation Fundamentals

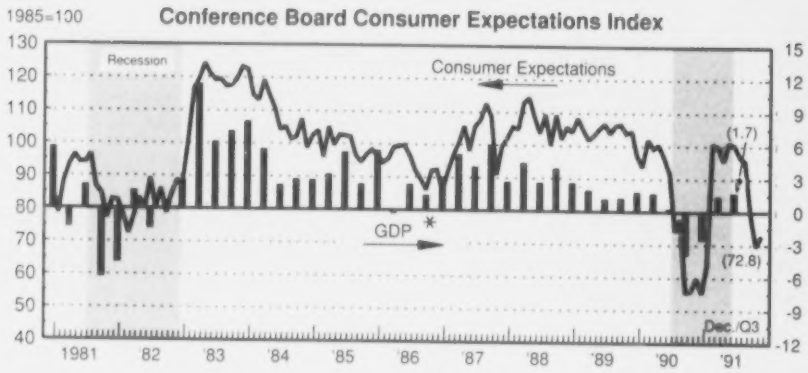
* Core Inflation = CPI excluding food at home and energy

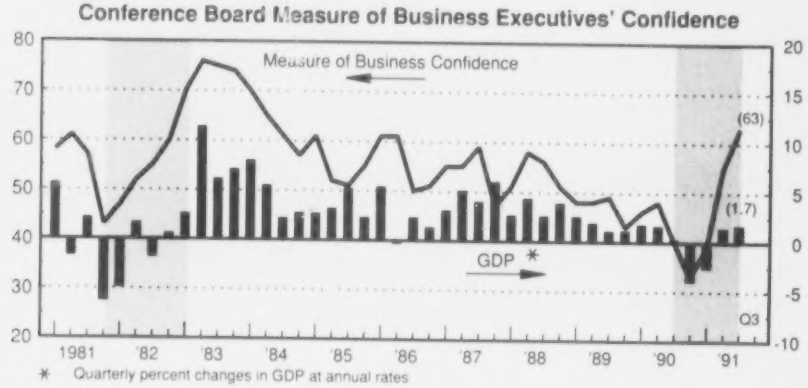


* Core employment-cost inflation = wages and salaries of private sector workers excluding sales personnel (i.e., excluding the benefits that are part of the ECI).

Conference Board Stat File

Confidence

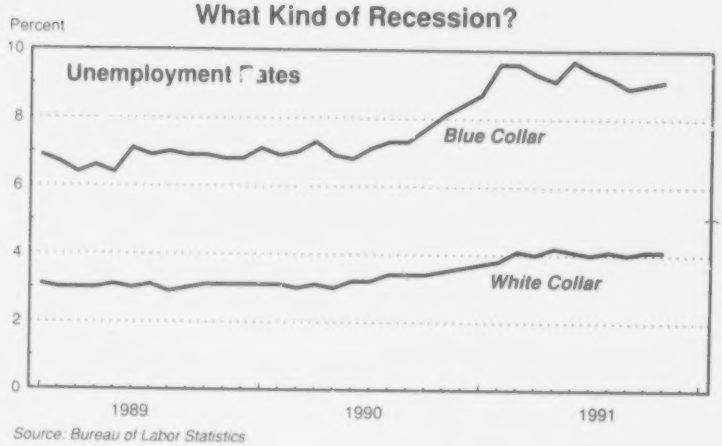




Consumer expectations very depressed.

Chart of the Month

Historically, blue-collar workers have always borne the brunt of recessions. The current business cycle, however, has often been perceived very differently, as one in which accountants, clerks, and managers were the main targets of the layoffs. Indeed, this was often called a white-collar recession. As the chart shows, however, that was a misperception. This recession, like its predecessors, is predominantly blue-collar in its impact.



Source: Bureau of Labor Statistics

Inside the Crystal Ball

			UCLA	MERRILL L.	DU PONT	GEORGIA ST.	NORTHERN TRUST	CONF. BOARD	EATON	L.H. MEYER	DRI	WEFA	MICHIGAN - RSQE		
Date of Forecast			Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.	Nov.		
National Economic Output (GDP or GNP)			(Quarter-quarter percent change, constant dollars, seasonally adjusted at annual rates)												
			%	%	%	%	%	%	%	%	%	%	%		
Actual	1991	2Q	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	2Q 1991	Actual
		3Q	2.4	1.7	1.7	1.7	2.8	1.7	1.7	1.7	2.0	2.1	2.4	3Q	
Forecast		4Q	-0.5	-1.0	-0.6	-0.5	1.8	0.3	1.7	0.0	0.6	1.8	0.9	4Q	Forecast
	1992	1Q	-1.0	-1.0	-0.1	0.4	1.8	1.1	2.5	1.1	-0.4	1.0	2.2	1Q 1992	
		2Q	1.4	2.4	3.8	1.1	3.7	1.6	3.9	2.5	2.6	2.8	3.0	2Q	
		3Q	2.9	3.4	4.4	3.2	3.4	2.4	4.0	3.7	4.3	4.0	3.9	3Q	
		4Q	3.3	3.1	4.4	3.2	3.4	3.1	3.8	3.6	4.4	3.9	3.2	4Q	
	1993	1Q	3.4		3.4			2.0	3.9	3.0	4.1	2.5	3.1	1Q 1993	
		2Q	4.1		3.5			2.4	2.7	2.9	3.0	2.5	2.7	2Q	
		3Q	3.3		3.3			1.4	1.9	3.0	2.1	3.1	2.4	3Q	
		4Q	2.6		3.3			1.7	2.8	3.3	1.7	2.5	2.1	4Q	
Inflation (Deflator)			(Percent change from same quarter one year earlier)												
Actual	1990	4Q	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	1990 4Q	Actual
Forecast	1991	4Q	3.4	3.4	3.3	3.2	3.6	3.2	2.1	3.4	3.2	3.1	3.4	1991 4Q	Forecast
	1992	4Q	1.8	3.8	3.6	2.8	3.4	3.6	2.9	2.6	3.2	1.8	3.0	1992 4Q	
30-Yr Treasury Bond Rate			(Percent, quarterly)												
Actual	1991	2Q	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	8.3	2Q 1991	Actual
		3Q	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2	3Q	
Forecast		4Q	7.8	7.9	7.8	7.9	7.9	7.9	7.8	7.9	7.9	7.9	7.8	4Q	Forecast
	1992	1Q	7.5	7.7	7.5	7.5	7.6	7.7	8.0	7.5	7.5	7.6	7.7	1Q 1992	
		2Q	7.6	7.8	7.3	7.6	7.5	7.7	8.0	7.6	7.4	7.6	7.6	2Q	
		3Q	7.6	7.9	7.2	7.9	7.6	7.7	8.0	7.6	7.4	7.7	7.6	3Q	
		4Q	7.7	8.0	7.2	7.9	7.7	8.0	7.9	7.7	7.6	7.8	7.5	4Q	
	1993	1Q	7.8		7.2		7.8	8.1	7.9	7.7	7.8	7.9	7.4	1Q 1993	
		2Q	7.8		7.3		7.9	8.2	8.0	7.7	7.9	7.9	7.4	2Q	
		3Q	7.9		7.4		8.0	8.3	8.0	7.6	8.0	8.0	7.3	3Q	
		4Q	8.2		7.5			8.6	8.0	7.5	8.2	8.1	7.2	4Q	
Unemployment Rate			(Percent, quarterly)												
Actual	1991	1Q	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	1Q 1991	Actual
Forecast	1991	4Q	7.0	6.8	6.8	6.9	6.8	6.9	6.9	6.9	6.8	7.0	6.9	4Q 1991	Forecast
	1992	4Q	7.5	6.7	6.3	6.9	6.5	6.6	6.6	6.8	6.5	7.1	6.5	4Q 1992	
	1993	4Q	6.8		5.9			6.3	6.1	6.0	6.0	6.7	6.1	4Q 1993	